No. 2670

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

SACRAMENTO VALLEY ELECTRIC RAILROAD COMPANY (a corporation),
Plaintiff in Error,

vs.

TAGGART ASTON,
Defendant in Error.

BRIEF FOR PLAINTIFF IN ERROR.

A. C. HUSTON,
BLACK & CLARK,
Attorneys for Plaintiff in Error.

Filed this.....day of March, 1916.

FRANK D. MONCKTON, Clerk.

By.....Deputy Clerk.

INDEX.

No. 2670

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

SACRAMENTO VALLEY ELECTRIC RAILROAD COMPANY (a corporation),
Plaintiff in Error,

vs.

TAGGART ASTON,
Defendant in Error.

BRIEF FOR PLAINTIFF IN ERROR.

Introduction.

The plaintiff, Taggart Aston, obtained judgment in the United States District Court for the Northern District of California, against the defendant, Sacramento Valley Electric Railroad Company, a corporation, for $2350, for an alleged repudiation on October 1, 1913, of an alleged contract for services in getting up a report on the probable cost and earnings of a railroad defendant desired to build from Dixon in Solano County, to Red Bluff in Tehama County, California. The action was tried by the court. Defendant is here upon writ of error

complaining of the said judgment rendered by the trial court.

It was averred in the complaint that in addition to the services which plaintiff was to perform personally, he was to cause certain services to be performed by one, Wilsey, in presenting the proposition for the purchase of defendant's bonds to prospective purchasers in London and on the continent of Europe. The whole of the evidence in the cause revolved about a certain writing which was the basis of plaintiff's claim. This writing refers to Wilsey, although it does not state directly any obligation on plaintiff's part to have Wilsey perform services. The writing in question was as follows:

> "San Francisco, Cal., Sept. 22, 1913.
> Mr. Charles L. Donohoe,
> President Sac. Valley Electric R. R. Co.,
> San Francisco, California.
> Dear Sir:
> Relative to our conversation this morning I am prepared to start on gathering data and preparing a report at once of your railroad project. Terms to be—
> $ 3500 for complete report and data,
> 750.00 to be paid a week from to-day,
> 750.00 in two (2) weeks from next Monday,
> 500.00 two (2) weeks thereafter,
> 500.00 two (2) weeks after that time, provided the last $500 is not to be paid until my report is completed and $1000.00 on your hearing from Mr. Wilsey, from London, that the matter is receiving favorable consideration.

In the event of Mr. Wilsey reporting to you that the matter is not to go through, the last $1000.00 is not to be paid.

I am prepared to give Mr. Wilsey preliminary data and report to take with him within the next week or so.

My report will be complete, showing the estimates of cost of construction in detail and possible traffic and returns for the road, based upon actual investigation in the field and examination of traffic conditions and possibilities of returns for your railroad and comparisons with the possible earnings of this road as compared with the known earnings of other similar roads in the Sacramento Valley. A copy of my report will be delivered to your company upon completion.

Of course you will give me every facility you may have for travelling in the Valley.

Yours very truly,
(Signed) TAGGART ASTON,
Consulting Engineer.
The above approved.
(Signed) E. L. SISSON,
(Signed) H. W. MANOR,
(Signed) C. L. DONOHOE,
Directors."

On this document plaintiff had made the following entry:

"Sept. 22d Pd. $150 on a/c and started work on report. (Signed) Taggart Aston (30)."

(Tr. p. 26.)

Finding 5 of the court was as follows:

"5. That on or about the 23d day of September, 1913, plaintiff entered upon the performance of his said contract with the defendant as aforesaid, and that thereafter and on or

about the 1st day of October, 1913, and without fault on the part of the plaintiff, and while plaintiff was engaged in the performance of his said contract, the defendant herein repudiated its said contract with the plaintiff, and refused to proceed further in the performance of said contract upon its part, and by and through its president, one Charles L. Donohue, *gave written notice to plaintiff to refrain from the preparation of said report;* that prior to the repudiation of said contract by the defendant as aforesaid, the defendant accepted the performance thereof on the part of the plaintiff herein as aforesaid, and paid the plaintiff on account of said contract the sum of one hundred fifty (150) dollars."

(Tr. pp. 16, 17.)

It will not be contended that this finding meant that defendant accepted more than an act of performance on plaintiff's part. The very next finding —finding 6,—shows defendant's persistent refusal to accept performance of the alleged contract and its continuous repudiation of the alleged contract.

(Tr. p. 17.)

The court did not find that any sum was due, owing and unpaid to plaintiff for services performed under a contract. The first count of the complaint averred that the contract had been repudiated and that damages resulted in the sum of $3350, and that $150 had been paid on the contract. The second count *averred performance of services for defendant* upon a contract and that the services were of the reasonable value of $3500, and that of the sum $3350 was due. The second count was based

upon a *quantum meruit*. The first count of the complaint is not a count for moneys due, owing and unpaid. It is founded on repudiation of the alleged contract, and it is upon the first count that the judgment for $2350 is based.

At the very time it is claimed the alleged contract was made, an order of the railroad commission of the State of California prohibited plaintiff from incurring any obligation in the construction of its road until it had $750,000 paid in for stock, and the order further provided that when any contract for the purpose named which should involve the expenditure of over $1000 should be made, it should be first submitted to the railroad commission for its approval. The statute creating the railroad commission prohibited all expenditures for purposes *not* specified in the commission's order. It prohibited expenditures for purposes specified in the commission's order except *on the conditions* therein named. *It expressly provided the commission might attach conditions to its order.* We respectfully contend that the trial court read an exception into the statute when by virtue of the express negation of the statute, such exception is impossible.

The Issues and the Ruling Complained of.

The case is not in any sense based upon full performance. *The court made no finding upon the count setting out the alleged reasonable value of*

services rendered (Tr. p. 4). The theory of the judgment is that plaintiff was entitled to these large damages because of an offer to perform. There is no evidence that could qualify the finding that within a week of the making the alleged contract, the defendant positively and *in writing* refused to accept performance. The alleged contract in no true sense was ever carried out. Not a particle of the character of investigation contemplated ever occurred. On October 1, 1913, the company through its president, Mr. Donohoe, wrote Mr. Aston that the company would not make what Donohue regarded as a proposed contract. Donohoe had paid $150 to Aston *out of his own pocket*. The company never acknowledged the debt. Negotiations were ended. If a contract ever was made, we earnestly urge that we have here nothing but the plain case of the prompt repudiation of an illegal contract for which damages are not recoverable.

Defendant pleaded and emphatically contended that it never made any contract whatsoever with plaintiff. It contended that it clearly and specifically called negotiations off before any contract was consummated, that the $150 in question had not been paid except out of the president's funds. It contended that any such contract would have been illegal and in plain violation of the orders of the railroad commission of the State of California, and in plain violation of law in the absence of such orders. It pleaded that the alleged contract was illegal (Tr. pp. 12, 13). Upon the issue as to

whether there was an agreement, we are here foreclosed by the inferences and finding of the trial court against defendant, but upon the issue as to whether the court properly found and held the contract was lawful, we are sustained by oral and documentary evidence in which there is no conflict. Defendant specifically requested a favorable finding on this issue, and the request was denied and exception noted and allowed by the court (Tr. pp. 22, 23). The court found specifically to the contrary (findings 7, 8, 9 and 10, Tr. pp. 17, 18).

Our request was as follows:

> "The defendant duly requested the court that it find and determine that defendant could expend its funds for only such purposes as were directed or permitted by the orders of the railroad commission of the State of California; that at the time alleged in the complaint defendant did not have legal authority and was not authorized in law to make the contract alleged in the complaint or to employ plaintiff to render services or to agree to pay him the sums alleged in the complaint; and that under and by virtue of the orders of the said railroad commission controlling the disbursement and expenditure of the funds of defendants, its funds could not be legally applied in payment of the obligations mentioned in the complaint and that the court should determine that plaintiff was not entitled to recover for said reasons. This request so made by the defendant was denied by the court, the defendant noting its exception, which was allowed by the court."
>
> (Tr. pp. 22, 23.)

This ruling is covered by assignment of error, as follows:

> "1. The court erred in refusing to determine and find that defendant could expend its funds for only such purposes as were directed or permitted by the orders of the railroad commission of the State of California; that, at a time alleged in the complaint, defendant did not have legal authority and was not authorized to make the contract alleged in the complaint or to employ plaintiff to render services or to agree to pay him the sums alleged in the complaint; and that, under and by virtue of the orders of the said railroad commission controlling the disbursement and expenditure of the funds of defendant, its funds could not be legally applied in payment of the obligations mentioned in the complaint and that the plaintiff was not entitled to recover for said reasons."
>
> (Tr. pp. 90, 91.)

It was contended in the trial court that the statute relied upon, creating a railroad commission and defining its powers, could not and did not apply to this case. The learned trial court held the statute was inapplicable. We respectfully contend that this was error, that the statute in question plainly applied to this case, and that the statute and its restrictions and the restrictions that were created in pursuance of it, were entirely valid; that those restrictions applied just as clearly as they would have applied to a contract involving an expenditure of $5000, which it was proposed should be made with one Wilsey for his expenses.

The findings made by the court in opposition to plaintiff's request are as follows:

"7. That it is not true, as alleged in the defendant's answer, that, under and by virtue of the laws of the State of California, or by any other law or laws, the defendant was at all the times mentioned in the complaint, or now is, under the jurisdiction of the Railroad Commission of California, to the extent that it was, or is, only authorized to enter into such contracts and to expend its funds for such purposes as were and are directed by the Railroad Commission of California.

8. That it is not true, as alleged in the defendant's answer, that, at all the times alleged in plaintiff's complaint, or at any other time, the defendant was not authorized, and did not have the legal authority, or any capacity, right or power to make or enter into any contract with the plaintiff, or to employ plaintiff to render any of said services, or to pay to the said plaintiff any of the sums alleged in plaintiff's complaint.

9. That it is not true, as alleged in the defendant's answer, that, under and by virtue of the orders of the Railroad Commission of the State of California governing and controlling the disbursement and expenditure of the funds of said defendant, none of said funds could be legally applied to the payment of said obligations alleged in plaintiff's complaint, or to any of them.

10. That it is not true, as alleged in the defendant's answer that the said defendant had no legal capacity or authority to make or enter into said contract, as alleged in the first cause of action in said complaint, or to make or enter into any of the agreements alleged in said complaint."

(Tr. pp. 17 and 18.)

The Statute of California Involved.

The "Public Utilities Act" of California of 1911 applied to defendant. Defendant was incorporated as a public service railroad corporation. The court found it was "incorporated on May 4, 1912".

(Tr. p. 15.)

> "It was admitted defendant was incorporated as a common carrier and was within such jurisdiction as the Railroad Commission of the State of California has over a state railroad corporation."
>
> (Tr. p. 46.)

> "A. C. Huston, counsel for defendant, testified, in substance: That he was one of the directors of the defendant, in September, 1913; that the board consisted of seven members; that, as attorney for the company, he had prepared the Articles of Incorporation, dated April 26, 1912;"
>
> (Tr. p. 56.)

The act of the legislature of the State of California, known as the "Public Utilities Act", adopted December 23, 1911, and which, under the present referendum section (art. IV, sec. 1) of the state constitution, went into effect on March 23, 1912, created a railroad commission, and vested it with certain powers, among which was the supervision of the acts of the directors of a "public utility" in making use of the funds which the stockholders of the corporation might subscribe to build its road. The act was, therefore, unques-

tionably applicable to this case. In express terms it applied to a corporation such as the defendant.

Cal. Stats., Ex. Sess. of 1911, pp. 18, 34, 35.

We shall endeavor to show that it applied to the alleged act of the defendant here involved.

In examining the statute next mentioned and in viewing the orders of the railroad commission in question and the alleged contract in the light of that statute, we ask the court particularly to note:

1. That it permits an expenditure of the money paid into the corporation by the stockholders *only* in the event the railroad commission has made an order permitting the expenditure for the purpose intended.

2. That the order made may be upon *conditions* fixed by the commission.

3. *That if the order does not permit the expenditure the statute prohibited it.*

Section 52 of the Public Utilities Act in question contains the following provisions:

> "Sec. 52. (a) The power of public utilities to issue stocks and stock certificates, and bonds, notes and other evidences of indebtedness and to create liens on their property situated within this state is a special privilege, the right of supervision, regulation, restriction and control of which is and shall continue to be vested in the state, and such power shall be exercised as provided by law and under such rules and regulations as the commission may prescribe.
>
> * * * * * *

(b) A public utility may issue stocks and stock certificates and bonds, notes * * *. Provided, that such public utility, in addition to the other requirements of law, shall first have secured from the commission an order authorizing such issue and stating the amount thereof and the purpose or purposes to which the issue of the proceeds thereof are to be applied, and that, in the opinion of the commission, the money, property or labor to be procured or paid for by such issue is reasonably required *for the purpose or purposes specified in the order,* and that, except as otherwise permitted in the order in the case of bonds, notes or other evidences of indebtedness, such purpose or purposes are not, in whole or in part, reasonably chargeable to operating expenses or to income. To enable it to determine whether it will issue such order, the commission shall hold a hearing and may make such additional inquiry or investigation, and examine such witnesses, books, papers, documents and contracts and require the filing of such data as it may deem of assistance. *The commission may by its order grant permission for the issue of such stocks or stock certificates, or bonds, notes* or other evidences of indebtedness in the amount applied for, or in a lesser amount, or not at all, **and may attach to the exercise of its permission such condition or conditions as it may deem reasonable and necessary.** The commission may authorize issues of bonds, notes or other evidences of indebtedness, less than, equivalent to or greater than the authorized or subscribed capital stock of a public utility corporation, and the provisions of sections 309 and 456 of the Civil Code of this state, in so far as they contain inhibitions against the creation by corporations of indebtedness, evidenced by bonds, notes or otherwise, in excess of their total authorized or subscribed capital stock

shall have no application to public utility corporations. *No public utility shall without the consent of the commission, apply the issue of any stock or stock certificate, or bond, note or other evidence of indebtedness, or any part thereof, or any* **proceeds** *thereof, to any purpose* **not** *specified in the commission's order,* or to any purpose specified in the commission's order *in excess* of the amount authorized for such purpose, or issue or *dispose of the same on any terms less favorable than those specified* in such order, or a modification thereof.

* * * * * *

(d) All stock and every stock certificate, and every bond, note or other evidence of indebtedness, of a public utility, issued without an order of the commission authorizing the same *then in effect* shall be void, and likewise all stock and every stock certificate, and every bond, note or other evidence of indebtedness, of a public utility, issued with the authorization of the commission, but not conforming in its provisions to the provisions, if any, which it is required by the order of authorization of the commission to contain, shall be void.

* * * * * *

(e) *Every public utility which, directly or indirectly,* issues or causes to be issued any stock or stock certificate, or bond, note or other evidence of indebtedness, in non-conformity with the order of the commission authorizing the same, or contrary to the provisions of this act, or of the constitution of this state, *or which applies the proceeds from the sale thereof, or any part thereof, to any purpose* **other than** *the purpose or purposes specified in the commission's order, as herein provided,* or to any purpose specified in the commission's order *in excess* of the amount in said order authorized for such purpose, is *subject to a penalty of not*

less than five hundred dollars nor more than twenty thousand dollars for each offense.

(f) Every officer, agent or employee of a public utility, *and every other person* * * * who, *directly or indirectly,* knowingly applies, or causes or assists to be applied the proceeds or any part thereof, from the sale of any stock or stock certificate, or bond, note or other evidence of indebtedness, *to any purpose* **not** *specified* in the commission's order, or to any purpose specified in the commission's order, *in excess* of the amount authorized for such purpose, or who, with knowledge that any stock or stock certificate, or bond, note or other evidence of indebtedness, has been issued or executed in violation of any of the provisions of this act, negotiates, or causes the same to be negotiated, *shall be guilty of a felony.*"

Cal. Stats., Ex. Sess. of 1911, pp. 45, 46, 47, 48.

Section 79 of the act also applies to individuals and makes criminal the act of *any person* who aids or abets any public utility in its non-compliance with or failure to comply with the statute.

Cal. Stats., Ex. Sess. of 1911, p. 62.

Section 81 of the act makes it a contempt for the public utility or *any person* to disobey the commission's order. This remedy is declared to be cumulative.

Cal. Stats., Ex. Sess. of 1911, p. 62.

The statute was passed under an amendment to the constitution, sec. 20 of art. XII, adopted on October 10, 1911, and its validity has been repeat-

edly recognized by the Supreme Court of the State of California since the decision in the case:

Pac. Tel. & Tel. Co. v. Eshleman, 166 Cal. 640.

But very recently, on January 29, 1916, the Supreme Court of California ruled that the provisions of section 52 of the statute which refer to section 309, Civil Code, are entirely effective; that the commission *may determine when a public utility shall incur debts in excess of its capital stock.*

Moss v. Smith, 51 Cal. Dec. 125.

The uncontradicted evidence showed that the alleged contract, if made, plainly contemplated the use of the funds of the defendant company which had been paid in by subscribers for stock; that $750,000.00 had not been paid in for stock as required by the commission's order as a condition to incurring of any obligation, and that the alleged contract called for payment of over $1000.00. The court in the progress of the trial intimated that it was implied in the commission's order that expenditures might be made. But, as we understand, the final position of the court was that the statute did not apply to the alleged contract. *If the order did imply certain expenditures should be made, it did not imply that contracts in excess of $1000 could be made regardless of the order.* The alleged contract was not submitted to the commission as required by its order, and in that respect was in further violation of the order. It is the

funds paid in for stock which the state law holds in trust and permits to be expended only for the purposes specified in the commission's order. In language too plain for argument, this law denies the right to a public service corporation to use stock subscription money except under the commission's orders, and in terms equally plain it denies the right to any contractor to reach such funds unless there is the same sanction. The act not only penalizes any violation of the law, but it expressly prohibits the making of the expenditure except under the conditions named in the order. And it denounces the violation of its requirements as unlawful. It is not a case therefore where the court is called upon to determine whether from the fact a penalty is imposed it may or may not be implied that a contract made in violation of the statute is unlawful.

The Supreme Court of California, following the principles of the case of Harris v. Runnels, 53 U. S. 79; 13 L. ed. 901, laid down the law applicable to a prohibitory statute of the kind we are here dealing with as follows:

> "It is of course undisputed that a contract in violation of a statute is void, and no difficulty can arise in such a case. More trouble has been experienced by the courts where the case has been one in which there has been no express prohibition of the act, but where a penalty for the performance or non-performance has been imposed. A statute may either expressly command, prohibit, or enjoin an act, or it may impliedly command, prohibit, or

enjoin it by fixing a penalty for the non-performance or commission thereof. As to the effect of such implied prohibitions there was much divergence of opinion upon the part of the English judges, and this difference of view found its way into conflicting and irreconcilable decisions of the courts of our different states. Thus in Brown v. Duncan, 10 B. & C. 93, the action was on a guaranty for sales of liquor, which had been distilled without a license under a statute requiring a license and affixing a penalty. It was held that these were mere revenue regulations, and that a breach did not render the trade so illegal as to prevent a recovery for sales. This case was distinguished from the case of Law v. Hodgson, 2 Camp. N. P. 147, which was an action for the value of bricks of dimensions smaller than that required by statute, which statute affixed a penalty for violation. The statute declared merely that bricks shall be made of such dimensions. Lord Ellenborough said: 'The first section of this statute absolutely forbids such bricks to be made for sale. Therefore, the plaintiff, in making the bricks in question, was guilty of an absolute breach of the law; and he shall not be permitted to maintain an action for their value.' The distinction declared in Brown v. Duncan was that the statute in Law v. Hodgson was designed to protect the public; while that in the case before them was a mere revenue regulation. The influence of these and other like decisions, appealing, as they have, with differing force to the judges of our state courts, has led to much confusion of decision; a confusion, however, which the learned decision of the supreme court of the United States in Harris v. Runnells, 53 U. S. 79, should do much to eliminate. *But it is to be noticed that every case from every court recognizes that when a statute*

has been made for the protection of the public, a contract in violation of its provisions is void. (Woods v. Armstrong, 54 Ala. 150, (25 Am. Rep. 671); Griffith v. Wells, 3 Denio, 226; Cope v. Rowlands, 2 Mees. & W. Rep. 149; United States Bank v. Owen, 27 U. S. 526; Burck v. Taylor, 152 U. S. 634 (14 Sup. Ct. 693); Miller v. Ammon, 145 U. S. 421, (12 Sup. Ct. 884); Berka v. Woodward, 125 Cal. 119; (73 Am. St. Rep. 71, 57 Pac. 777); Jackson v. Shaw, 29 Cal. 267; Johnson v. Simonton, 43 Cal. 242.)

* * * * * *

It has further been shown that where a statute, designed for the protection of the public, prescribes a penalty, that penalty is the equivalent of an express prohibition, and that a contract in violation of its provisions is void. 'Whenever the illegality appears, whether the evidence comes from one side or the other, the disclosure is fatal to the case.' (Coppell v. Hall, 74 U. S. 542; Berka v. Woodward, 125 Cal. 119, (73 Am. St. Rep. 31, 57 Pac. 777.)"

Levinson v. Boas, 150 Cal. 192, 193.

Detailed Statement of Facts.

Defendant company, as heretofore stated, was organized on May 4, 1912, for the purpose of constructing a railroad from Dixon, in Solano County, to Red Bluff, in Tehama County, California.

On May 3, 1912, the company applied to the railroad commission for permission to sell and make use of the proceeds of the sale of its stock.

Upon August 13, 1912, this application was acted upon.

(Tr. pp. 56, 57.)

On the date last named,—August 13, 1912,—the railroad commission made a certain order which was in force and which Aston knew was in force at the very time of the alleged contract of September 22, 1913. It is set out in the transcript and it plainly did not permit the alleged contract. It contained the following provisions:

> "*Construction of the road shall not be entered upon nor liability created,* nor money paid out except for commissions as aforesaid *until there shall be in the hands of the company from the sale of stock $750,000.*
>
> The *proceeds* from the sale *of* said preferred *stock shall be used for the following purposes:*
>
> *For the purchase of materials and rolling stock and the construction of an electric railroad in certain territory all as set out in detail in the application and exhibits attached thereto and filed therewith.*
>
> Said company shall keep separate, true and accurate accounts showing the receipt and application in detail of the proceeds of the sale or exchange of said stock hereby authorized to be issued and on or before the 25th day of each month the company shall make a verified report to the commission in accordance with the commission's general order No. 24, stating the sale or disposal of such stocks during preceding month, the terms and conditions of such sale or other disposition, the moneys or property realized therefrom and the use and application of such money or property. *And in addition thereto said company shall submit to this commission for its approval the form*

of all contracts for the sale or exchange of stock and before the execution thereof all contracts for grading, bridging, track, including materials and labor, equipments of all kinds and all materials, labor and property involving costs in excess of $1000.

The authority hereby given to issue such stock shall apply only to stock issued by said company on or before the 1st day of August, 1913."

(Tr. pp. 65, 66.)

The order was in no respect material to this case, modified by the later order of September 27, 1913, which went in evidence. That order was made upon an application to the commission made *"previous to the negotiations with Mr. Aston"*.

(Tr. p. 66, bottom of page.)

This order contained the same restrictions as did the old.

(Tr. pp. 73, 74.)

It is simply impossible to read into these orders anything permitting the contract in question. *They did not permit any expenditures at all. They did not permit contracts in excess of $1000 even if they did imply that expenditures could be made.*

The testimony relative to the company's finances aside from the recitals in the orders was as follows:

"A. C. Huston further testified on his cross-examination:

'Mr. Blake. Q. At the time that this order was made, their (referring to the company, defendant) only source of income from any quarter was the sale of this stock?

A. That was the only source of income we (referring to the company, defendant) have ever had.'

A. C. Huston further testified on his redirect examination:

'Mr. CLARK. Q. Some reference was made to a sum of $750,000 in the treasury before the company could proceed to do certain work or incur certain obligations; was that $750,000 in the treasury from the source designated in the commission's order?

A. We never have had that amount at any time.' "

(Tr. p. 90.)

The learned trial court found the contract was legal and gave an absolutely general judgment to the plaintiff. The alleged contract furnishes no support for such a judgment. The statute is plain. *The alleged contract intended the use of the proceeds of stock sales. There were no other moneys with which the payments could have been met.* If the statute can be read with an exception that will support this case, there is no certainty to the statute and the authority of the commission is indefinite and meaningless. If the law could be read as justifying payment for services fully performed, that, as we shall show, would furnish no legal ground for payment upon an illegal contract that has been repudiated.

The evidence, as appears from the testimony just quoted, was without conflict that the only funds with which defendant could have met the payments called for by the alleged contract were moneys

contributed by those who had subscribed for stock of the company. *The evidence showed without conflict that Aston knew the company had just been organized; that its railroad project was in a formative period; that no railroad had been built and that the company could not have earned a dollar with which to meet the payments of his alleged contract; he knew positively that if his contract was made, it contemplated it should be discharged out of money resulting from the sales of stock. He specifically understood no bonds had been sold and if bonds had been, the use of the money derived therefrom was subject to the same statutory restrictions as the use of money derived from sales of stock.*

Cal. Stats., Ex. Sess. of 1911, p. 46 (sec. 52).

We shall show the uncontradicted evidence as to Aston's knowledge; that he knew full well of the order of the railroad commission of August 13, 1912, at the time he claims his contract was made, and that he knew, through correspondence with which he was perfectly familiar, of the restrictions contained in that order.

He was associated with one Wilsey. Wilsey was a bond salesman. The company contemplated a bond issue. Wilsey came in contact with the company in August and September, 1913 (Tr. p. 23). Wilsey had gone over the line of the proposed railroad of the company with some of the directors of the company, and in the negotiations between

Wilsey and C. L. Donohoe, president of the company, Wilsey had specified two conditions to his undertaking to sell the company's bonds in Europe: First, that he should be paid $5000 to cover the expense of his trip to Europe (this although he was going to Europe anyway); second, that plaintiff Aston should get up a report on the cost and probable earnings of the road for a figure not at the time stated. The proposition of paying the $5000 was practically rejected. It never was submitted to the directors of the company. It was not agreed to. Aston knew of this before he ever presented the proposition involved in his alleged contract to the board of directors of the company; he knew that the company had said it could not, if it would, contract to pay the $5000 without an order of the railroad commission, and that his associates, Wilsey, and Donohoe had both been of the opinion that if a bond sale contract were presented to the railroad commission others might defeat the sale of the bonds. Aston knew of these very matters when he first broached the proposition of his alleged contract to the directors of the company. He states he made his alleged contract with this knowledge; that he expected to share in the profits Wilsey might make and *that he expected through the payments made to him to meet the very demands Wilsey had made.*

The court will note the alleged contract is dated *September 22, 1913.*

On *September 15, 1913,* Donohoe wrote Wilsey as follows:

"San Francisco, September 15, 1913.

Mr. W. J. Wilsey,
Palace Hotel,
San Francisco, Calif.

Dear Sir:

Your communication, relative to financing of the railroad, received and seems satisfactory *except as to the advancing you expenses of your trip to Europe, not to exceed $5000.*

The order I have from the railroad commission under date of August 13th, 1912, permitting us to proceed, provides:

That we can not incur an indebtedness or make a contract for more than $1,000.00 without obtaining the approval of the commission.

In order to comply with your demand in this respect we would have to go to the commissioner and necessarily have a hearing on the matter, and it would have to be disclosed to whom the money was going and the purpose of the same, and that would become a public record and might possibly be disastrous to our plans. *In addition we would have to make a showing as to the probabilities and possibilities of your success in the matter.*

I had hoped that the commission of 2½% would be sufficiently large to justify you financing your own trip, and, necessarily, you must know now the possibilities of your success and from our conversation it would seem that you are not taking much chance in the matter.

I would like to hear from you on the subject.

(Signed) Your very truly,
CHARLES L. DONOHOE."

(Tr. pp. 47, 48.)

In this letter Donohoe not only suggested the existence of the railroad commission, its authority and its order, but he in effect told both Mr. Wilsey and Mr. Aston that the stockholders' money could not be paid unless the commission was first satisfied the payment would not be useless. Would plaintiff contend a contract to pay the $5000 would have been legal? This question has not been answered. What was the difference between Aston and Wilsey, between the demands of the one and the demand of the other?

On September 16, 1913, Donohoe wrote Wilsey a letter of similar import. It contained the following:

* * * * * *

"You are going to Europe anyway. In fact, I understood you to say that your arrangements have been made to leave here about the *25th* for New York, etc.

* * * * * *

You realize as stated in my letter of last evening, that it would be disastrous to our whole scheme for me to go to the commission for *an order authorizing this expense,* and there is no way to charge this item of expense without disclosing the real nature of it, and it would be a hazardous thing to do in any event. That of course you will readily understand. It would involve a public hearing which, under all conditions, must be avoided.

I will appreciate a frank and friendly letter from you on the subject at an early date.

Of course, I would be willing to guarantee to you the paying back of your expenses for your trip, not to exceed $5000.00, in the event

that your mission in our behalf there should fail through any cause which originates with us.

Yours very truly,

(Signed) CHARLES L. DONOHOE,
President."

(Tr. p. 50.)

In plain terms this letter states the expenditure was not authorized by the order of the railroad commission.

On September 18, 1913, Wilsey wrote Donohoe a letter, concluding as follows:

"I quite understand the difficulty with the railroad commission in California, but you people who are largely interested should not hesitate to gamble on such a splendid enterprise.

With my best wishes to you and your project, I am

Yours very truly,

(Signed) W. J. W."

(Tr. p. 51.)

This letter shows that Wilsey was entirely familiar with the fact that no contract could be made for a purpose not within the commission's order.

On the same date, September 18, 1913, Wilsey wrote Donohoe a letter containing the following:

"You are quite right in not going before the railway commission. That must not be done in any event, but it seems to me that a small amount subscribed by each of you gentlemen interested would mean but little to you, to assist in putting the deal through, as no matter where you do this business, when it comes to

be done you will have to meet this same question, and in a much larger degree, as any broker will have to work up his syndicate. I do no business with brokers, and my syndicates are already established beyond question.

You say that you will be willing to guarantee the payment back to me of the amount named should I not be able to put the deal through," etc.

(Tr. p. 53.)

It is entirely evident that Wilsey figured the arrangement made should be a *personal* one. Both he and Donohoe have spoken of a guarantee.

And the letter concluded as follows:

"You should receive this letter on Saturday A. M., in time for your meeting, and I shall have to know at once so that I can spend the following week closing up matters. Would you do me the favor of writing me your final conclusion?

With esteem and friendship, I am

Yours truly,

(Signed) WILSEY."

(Tr. p. 54.)

It was on Saturday that Aston appeared before the board of directors. The letters were all written in San Francisco. But let us see how clearly he was aware of the very facts therein referred to. We quote from the record as follows:

"The plaintiff testified that, for introducing Mr. Wilsey to the company, *he understood he was to receive a share of the profits which Mr. Wilsey might receive,* although there was no definite agreement as to the matter; that he

met Mr. Wilsey at times at his hotel in San Francisco and **was familiar with the position taken by the company in its letters to Mr. Wilsey."**

(Tr. p. 56.)

"Q. Did you talk over with Mr. Wilsey the communications between Mr. Donohoe and Mr. Wilsey so as to keep conversant with their negotiations?

A. Naturally **I would talk over any communications that had passed prior to that time."**

(Tr. p. 45.)

"Q. Did you understand, before Mr. Wilsey went to Europe, that before this company would make any final contract with Mr. Wilsey for the disposition of its stock and bonds, it would be compelled to submit the proposition to the Railroad Commission?

A. It was understood that before any deal with any underwriters could be completed the terms of such underwriting would have to be submitted to the Railroad Commission.

Q. You understood that to apply to both the sale of stock and bonds of this company?

A. I understood that, yes, sir."

(Tr. p. 46.)

The plaintiff knew absolutely he had no right in the world to make the alleged contract.

The following additional testimony was given by plaintiff:

"The COURT. Q. But you were talking with Wilsey about the amounts required for his expenses; that had nothing to do with your contract?

A. *No; nothing to do with mine;* I had not guaranteed—*and I told Mr. Wilsey that inas-*

much as the company said it was impossible under the railroad commission's ruling to pay that money, they could arrange the money in installments so they could pay it.

Mr. CLARK. Q. Who said to you it was impossible under the Railroad Commission's orders?

A. I think Mr. Donohoe said it would be impossible to pay the large amount of $5,000 to Mr. Wilsey; *he said it would be too large an amount unless they made an application to the railroad commission.*

The COURT. Mr. Aston, I don't understand you. Had you made a proposition to Mr. Wilsey that you would yourself pay him the installments that you received from the company?

A. I told Mr. Wilsey that I would hold myself responsible for the payment of the $2500 to him."

(Tr. pp. 31, 32.)

On *Saturday, September 20, 1913,* and thereafter, according to plaintiff's testimony, the following occurred:

"* * * he thereupon submitted, at the request of the directors at the time of the meeting, a written proposition, that the members of the board all stated the proposition was fair and that a committee would be appointed to arrange the details of the contract, that the meeting was on a Saturday and that, on the Monday following, September 22, 1913, Mr. Donohoe sent for him, and that he met Mr. Donohoe and two other directors, Mr. E. L. Sisson and Mr. H. W. Manor at the office of the company; that Mr. Donohoe stated that the terms submitted by plaintiff were very satisfactory to the board but that a change should be made so as to provide that the first pay-

ment should be two weeks from date instead of immediately, and that they wanted plaintiff to go ahead with the getting up of a preliminary report at once so that Mr. Wilsey, who was about to go to London, could take such report with him to London on the following week; that thereupon the following instrument was signed: (Here follows writing already copied, see pages 2 and 3 of this brief.)

(Tr. pp. 23, 24.)

In fairness and to show defendant's entire good faith in emphatically denying the obligation relied upon, the court should note what is next herein set out. It is of course but the briefest summary of defendant's evidence, because we appreciate that this court will not review points on which the evidence conflicts and the bill is settled on that theory (Tr. p. 90, bot. of page):

"Defendant offered evidence in substance and effect that at the meeting of the board of directors on *September 20, 1913, it was stated on their behalf that no contract would be made with the plaintiff, unless it was approved by the railroad commission* and that the meeting adjourned without the giving of assent to any proposition and with the understanding that Mr. Wilsey was to come from Portland to San Francisco to meet the board *and that any proposition for the sale of the company's bonds or for the employment of plaintiff was to be taken up at the next meeting of the board;* that it was not stated that any committee or members of the board would act for the board in making a contract with plaintiff, but plaintiff denied that any such statements were made in his presence. The defendant further offered evidence to the effect that, at the time the

document, Plaintiff's Exhibit 3, was signed, it was stated by Mr. Sisson and Mr. Manor that it expressed what they would be willing to agree to if the railroad commission approved such a contract, but this was denied by the plaintiff."

(Tr. pp. 28, 29.)

The following rebuttal testimony offered by plaintiff was, in itself, sufficient to show his entire familiarity with the situation as regards the railroad commission.

"Mr. BLAKE. Q. At the meeting of September 20th of the board of directors of the present company was there anything said or done which would make your proffer of services contingent upon getting the sanction of the railroad commission?

A. *No, Mr. Blake, the only recollection I have of any conversation of that was that the directors endeavored to find some way of paying me that would comply with their powers; and on Monday afterwards they had apparently thought it over and they found out by paying me in these instalments they would be able to do so.* Of course, I was not concerned as to how they paid me or how they got the money, I simply knew that they wanted my services."

"Plaintiff further testified that he was, at the time of making of the contract, familiar with the fact that, during Mr. Wilsey's trip over the line of the proposed road, Mr. Wilsey had advised Mr. Donohoe that the company would have to put up $5000 to cover his, Wilsey's expenses, that Mr. Donohoe had told him that Mr. Wilsey had written him to that effect. The plaintiff further testified:

"Seeing there was no way for the company to pay *those expenses* I had promised in con-

> sideration of Mr. Wilsey allow me something out of the commissions that he might receive if he put the matter through. I had promised out of any money that I might receive to pay those expenses of Mr. Wilsey, and he said he would pay *half of them himself;* he expected them to come to $5000; *he said he would not ask the company or ask me to become responsible for more than $2500.* I wrote and told Mr. Wilsey or wired him, I forget which."
>
> (Tr. pp. 29, 30.)

It is impossible to conclude that a contract to pay $5000 to Wilsey would be bad without an order of the railroad commission, and that a contract to pay this plaintiff $3500 or ten times that amount would be good without such an order. The plaintiff in the testimony last quoted declared that, "Seeing there was *no way* for the company to pay those expenses" (referring to the $5000), he had promised to pay on to Wilsey part of his receipts. It is respectfully insisted that he could not be blind as to his own contract and with perfect vision as to the contract he claims he was making. It was an entire transaction with one, and only one, purpose.

It was expected, there is no question about it, that Wilsey, who had gone to Portland, Oregon, was to come back to San Francisco. We earnestly contended in the trial court that the paper of September 22, 1913, was a meaningless thing without an arrangement with Wilsey; that Aston knew he could not tender Wilsey's services unless an arrangement was made with him, Wilsey, that he knew no arrangement could be made with him,

Wilsey, without an order of the railroad commission and it must be conceded there is not one particle of evidence that showed Wilsey did agree with the company.

After this paper of September 22, 1913, relied on, was signed, which paper controlled the learned trial court in its decision, Aston wired Wilsey, referring again to the idea of a guarantee. He spoke of guaranties and of passing those on. It is proper for us to refer to these telegrams, at least for the purpose of showing Aston's situation in the negotiations, that he fully knew of the railroad commission and its relation to the alleged contract.

"Berkeley, Cal., Sept. 24, 1913.

Wm. J. Wilsey,
504 Selling Bldg.,
Portland, Oregon.

Payments *guaranteed* by *Donohoe* and *Manor* as per contract. Donohoe at Willows. Returns Friday but from phone conversation had with him this evening, I feel matter can be *arranged* to your satisfaction on *Friday* morning. Shall wire you then; your attitude correct, have strengthened my hand. ASTON."

(Tr. p. 30.)

It may be stated that Mr. Sisson testified that he was asked to guarantee the payments and refused to do so.

Aston's next telegram showed clearly his exact knowledge of the Wilsey-Donohoe negotiations.

"San Francisco, Sept. 26, 1913.

Wm. J. Wilsey,
504 Selling Bldg.,
Portland, Ore.

Donohoe unable return here until tomorrow therefore situation unchanged. I have ample guarantee money will be paid as per agreement. *Wish you would not press matter on full immediate payment further until you come here Tuesday as embarrasses me seriously* and am doing everything I can possibly do in your interests and to meet your requirements *shall pass guarantee on to you* in any way you wish upon your arrival Tuesday. You will then find Donohoe and directors willing and anxious to meet your wishes *in every way possible.* I shall ask Donohoe to wire you tomorrow.

TAGGART ASTON."

(Tr. p. 31.)

Donohoe's telegrams to Wilsey were as follows:

"San Francisco, Sept. 22, 1913.

W. J. Wilsey,
504 Selling Bldg.,
Portland, Oregon.

Your proposition acceptable. Directors desire personal conference prior to execution of *formal agreement* have made satisfactory *arrangements* with Aston who has commenced on report. When can you be here on way to England.

(Signed) C. L. DONOHOE."

"San Francisco, September 23, 1913.

W. J. Wilsey,
Selling Building,
Portland, Ore.

What document do you require. Can have them ready here on your arrival twenty-ninth. *It is essential that my directors have confer-*

ence with you. Will arrange to have directors' meeting 29th. Answer.

C. L. DONOHOE."

The alleged contract was specifically conditioned on an arrangement made with Wilsey. But no agreement was reached with him. He came to San Francisco and he and the company emphatically disagreed. Inferentially and from uncontradicted evidence, it must be held that knowledge of one was the knowledge of the other. The letter of September 15, 1913, from Donohoe to Wilsey was alone sufficient to establish knowledge. We ask the court's particular attention to that letter. Aston was to share in Wilsey's profits and specifically admitted he was familiar with the correspondence. (Letters written after October 1, 1913, the date on which the court specifically found the contract was repudiated by the company, show clearly the company already had elaborate and complete reports on its road. Tr. pp. 40, 41 and 42.)

The company, on September 22, 1913, was subject to an order of the railroad commission and plaintiff knew it. And before October 1, 1913, the date on which Donohoe, the president, wrote the letter specifically withdrawing from all relations with Aston, another order was made by the commission upon an application which had been filed before any of the negotiations with Wilsey or Aston. This order confirmed the first order, and did not in any way grant authority to make the alleged contract here involved.

On October 1, 1913, Donohoe wrote Aston, as follows:

"San Francisco, Oct. 1, 1913.

Mr. Taggart Aston,
Foxcroft Building,
San Francisco, Cal.

Dear Sir:

Relative to the report which it has been *proposed* you shall make for the Sacramento Valley Electric Railroad as to the cost of construction and possibilities of revenue of the proposed railroad of said company, will say that owing to a recent order of the Railroad Commission of the State of California, it becomes necessary to notify you to refrain from the preparation of said report as there is no way provided for paying you for such report at the present time.

It is also apparent that Mr. Wilsey is not going on with the proposition suggested.

Please return to this office the maps, profiles, and data furnished you in the matter.

Yours respectfully,
(Signed) CHARLES L. DONOHOE."

If there was a semblance of a contract, it was proper for the president to repudiate it by the foregoing letter, for any such contract was the incurring of a liability before the company had $750,000 in its treasury, the consideration exceeded $1000 and there was no order of the railroad commission permitting the contract.

Would a contract to pay Wilsey the $5000 have been valid? We ask that counsel explain wherein the difference lay between the two propositions. The alleged contract is invalid and so declared by statute because it is for a purpose not allowed

in an order of the railroad commission and because section 52, subdivision (b) expressly declares that the commission may attach conditions to its orders. A condition was attached in this case: No liability could be incurred until $750,000 had been paid in; and no contract for a purpose permitted in the order and involving an expenditure of over $1000, was to be valid unless such contract was approved *in advance* by an order of the railroad commission. It is entirely immaterial whether the order did imply some expenditures might be made. And if the order did not permit the contract, then the statute prohibited it.

Argument.

A presentation of the law of the case and a consideration of the points relied upon by plaintiff fall naturally under the following subdivisions:

I. The legislature has power to prohibit the making of a contract by a corporation so long as the contract does not relate to interstate commerce. The courts have no power to inquire into the reasonableness of such prohibitions or to hold that the statute must be construed as creating exceptions if the statute has negatived the idea of exceptions.

II. Had plaintiff not been created subsequent to the enactment of the public utilities statute, its regulations would still have been sustainable as a police measure. If the subject matter is one that

may be regulated, the courts will not strike down the legislative enactment. And it was proper for the legislature to say this corporation should not pay Aston $3500 for a report, or Wilsey $5000 for a trip to Europe to sell bonds, unless the railroad commission approved the proposition.

If a court can see any reason why a police regulation is appropriate in a given case to which it in terms applies, it cannot nullify the regulation by holding it inapplicable.

III. The power of the state exercised through commissions created under public utility statutes is validly exercised, as shown by the earlier cases and by cases already decided under the new enactments.

It is absolutely immaterial that in a given instance the act may have been violated by payments made on contracts *fully performed.*

There are reasons why a police regulation should apply in a case of this character, and the courts will not hold inapplicable a regulation which, by its terms, is applicable to this case.

IV. Where a contract is *ultra vires* and in addition void because it is prohibited, there is no case which holds that damages may be awarded for its non-fulfillment. It is properly repudiated before its performance.

V. While relief may be granted upon an irregular contract in case the power to contract is general and the mode of contracting is not restricted by a provision enacted in the interest of public

policy, yet where such a restriction exists, a contract made in disregard of it can give rise to no cause of action. Such statutes permit of no exceptions.

VI. Generally, damages are not recoverable for the breach of an illegal contract.

I.

THE LEGISLATURE HAS POWER TO PROHIBIT THE MAKING OF A CONTRACT BY A CORPORATION SO LONG AS THE CONTRACT DOES NOT RELATE TO INTERSTATE COMMERCE. THE COURTS HAVE NO POWER TO INQUIRE INTO THE REASONABLENESS OF SUCH PROHIBITIONS OR TO HOLD THAT THE STATUTE MUST BE CONSTRUED AS CREATING EXCEPTIONS IF THE STATUE HAS NEGATIVED THE IDEA OF EXCEPTIONS.

This is practically the statement of nothing but the proposition that a corporation is the creature of law. Its power can not rise higher than its source. It is quite common for state constitutions to contain provisions entitling the state legislature to withdraw powers conferred on a corporation by reserving the power to amend. Section 1, art. XII of the Constitution of the State of California provides:

> "Corporations may be formed under general laws, but shall not be created by special act. All laws now in force in this state concerning corporations, and all laws that may be hereafter passed pursuant to this section, may be altered from time to time, or repealed."

So long as vested rights are not invaded, there could be no restriction on the exercise of this power. Section 283 of the Civil Code of California reads:

> "A corporation is a creature of the law, having certain powers and duties of a natural person. Being created by the law, it may continue for any length of time which the law prescribes."

The proposition here considered was virtually declared in the case next referred to, which case, however, dealt with the regulation of the exercise of powers already granted to a corporation. When the state grants a charter to a corporation permitting it to transact business in which the public is interested, it impliedly reserves the power to regulate or stop the business of the corporation in order to prevent a misuse of the powers granted. The Supreme Court of the United States directly overruled the contention that such regulation would illegally impair the grant of powers:

> "This position cannot be sustained, consistently with the power which the State has, and upon every ground of public policy must always have, over corporations of her own creation. Nor is it justified by any reasonable interpretation of the language of the company's charter. The right of the plaintiff in error to exist as a corporation and its authority, in that capacity, to conduct the particular business for which it was created, were granted, subject to the condition that the privileges and franchises conferred upon it should not be abused, or so employed as to defeat the ends for which it was established and that, when

so abused or misemployed, they may be withdrawn or reclaimed by the state, in such way and by such modes of procedure as are consistent with law. Although no such condition is expressed in the company's charter, it is necessarily implied in every grant of corporate existence. (Terrett v. Taylor, 9 Cranch, 51; Ang. & Ames, Corp. (9th Ed.) sec. 774, note.)

Equally implied, in our judgment, is the condition that the corporation shall be subject to such reasonable regulations, in respect to the general conduct of its affairs, as the legislature may, from time to time, prescribe, which do not materially interfere with or obstruct the substantial enjoyment of the privileges the state has granted, and serve only to secure the ends for which the corporation was created. (Sinking Fund Cases, 99 U. S. 700; 25 L. ed. 496; Commonwealth v. Bank, 21 Pick., 542; Commercial Bk. v. Mississippi, 4 Sm. & M. 503.) If this condition is not necessarily implied, then the creation of corporations, with rights and franchises which do not belong to individual citizens, may become dangerous to the public welfare through the ignorance, or misconduct, or fraud of those to whose management their affairs are intrusted. It would be extraordinary if the legislative department of a government, charged with the duty of enacting such laws as may promote the health, the morals and the prosperity of the people, might not, when unrestrained by constitutional limitations upon its authority, provide, by reasonable regulations, against the misuse of special corporate privileges which it has granted, *and which could not, except by its sanction, express or implied, have been exercised at all.*"

Chicago Life Ins. Co. v. Needles, 113 U. S. 574; 28 L. ed. 1087.

Defendant is a corporation, it is a creature of the statute and it is a public utility and it is the intent manifest in the different parts and in the entire structure of the statute, which is a part of its being, that the orders of the commission, or the omission on the part of the commission to order, shall be respected. Section 30 of the act also declares the orders of the commission shall be obeyed. Section 31 gives a power of supervision and regulation to the commission. It can institute investigations of its own motion. That is a power that has existed in the legislative and executive departments of government. A corporation's powers, where the legislature has elected to reserve the right of repeal, may all be repealed.

The Holyoke Water-Power Co. v. Lyman, 15 Wall. 500; 82 U. S. 500; 21 L. ed. 133.

In the Dartmouth College case, the right to amend or repeal was not reserved.

The charter of a corporation formed under general law consists of its articles of incorporation, *taken in connection with the law under which the organization took place.* (Quoting from I Morawetz on Private Corporations, sec. 318; citing also, Cook on Corporations, sec. 669.)

Traer v. Lucas Prospecting Co., 124 Iowa 107; 99 N. W. 290, 292 (Col. 2).

A corporation derives its power only from the act, grant, charter or patent creating it. No act of the corporation will enlarge its powers.

Salem Milldam Corp. v. Ropes, 23 Mass. 23, 32.

Its violation of the law in one case could not make the law for another case.

This is entirely aside from the doctrine that a corporation may not plead that a contract is *ultra vires*. That principle does not mean that the state may not, independently of the police power, forbid the exercise of certain corporate power. It undoubtedly lies within the power of the state to make the plea of *ultra vires* a good plea in all cases, for the state has the power to deny corporate action in any form. It could restore the rule *which first existed* that neither the corporation or an individual dealing with it could rely on a contract which was *ultra vires* the corporation.

In the case next referred to the District Court for the Northern District of Virginia held that the Blue Sky Law of West Virginia was invalid, but did so expressly upon the ground that its terms applied to natural persons as well as to corporations, and that it also interfered with interstate commerce. Judges Pritchard and Dayton concurred in the opinion, Judge Woods dissented, holding the law valid. But in the majority opinion, speaking of the power of the legislature over corporate action, it was said:

> "The exercise of this control over the operations of corporations by state legislature is perfectly legitimate from the legal point of view, for ever since the decision in Bank v. Earle, 13 Pet. 519, 10 L. Ed. 274, it has been settled that a corporation can have no legal existence outside of the boundaries of the sovereignty by which it was created; that such corporations

> are not 'citizens' within the meaning of article 4, sec. 2, of the federal constitution, entitling them 'to all privileges and immunities', as such 'in the several states'; and the power of the states to determine the terms and conditions under which they, whether domestic or foreign, may do business in the state, has been repeatedly upheld, by the Circuit Court of Appeals for this circuit in Kirven v. Va. Car. Chem. Co., 145 Fed. 288, 76 C. C. A. 172, 7 Ann. Cas. 219; Cumberland Gas Light Co. v. West Va. & Md. Gas Co., 188 Fed. 585, 110 C. C. A. 383.
>
> A state legislature may therefore prevent foreign corporations from transacting business altogether within its territorial limits, and it may limit all corporations, foreign and domestic, as to what particular kind of business they may or may not do within the state. *So far as they are concerned, it is not a question of police power nor of interstate commerce, but purely and simply the exercise of a well recognized sovereign power over these artificial bodies."*
>
> Bracey v. Darst, 218 F. 480, 494, 495.

The court plainly indicated that if the statute had been framed like the Florida statute, it would have upheld it for the reasons declared in an opinion rendered by the Supreme Court of Florida. The Florida statute did not contain the obnoxious provisions relating to natural persons.

As regards foreign corporations, it has been repeatedly ruled, the state has complete power to prohibit them from making any sort of contract relating to intrastate business.

> Hooper v. California, 155 U. S. 648; 39 L. ed. 297.

This rule is of course inapplicable if the commerce involved is interstate.

International Text Book Co. v. Pigg, 217 U. S. 91; 54 L. ed. 678;

Buck Stove & Range Co. v. Vickers, 226 U. S. 205; 57 L. ed. 189.

The first case decided by the Supreme Court of California which dealt with the powers of the new railroad commission makes it evident that the legislative department clearly intended that the public utilities act should be construed as conferring on the railroad commission a legislative-administrative body—plenary power to control the business of a public utility. The people of the state in amending section 22 of art. XII of the constitution declared that the constitutional provision and powers conferred in pursuance of it, were controlling over other sections of the constitution. The statute enacted denied the state courts the power to interfere with the orders of the commission except upon jurisdictional grounds. The right to review evidence upon which the commission acted was denied to the state courts, and the Supreme Court of the state alone was granted power to review the orders of the commission, upon jurisdictional grounds.

Pac. Tel. etc. Co. v. Eshleman, 166 Cal. 653 to 659.

The statute in question was passed under the fullest possible and most express constitutional sanction. It in plain terms says that a railroad company shall not dispose of the proceeds of stock

sales for any purpose until the railroad commission gives it sanction. The statute is too plain for construction.

The court can not add exceptions to it. It first declares the purpose of the expenditure must be declared in the order; it then, to remove the question still further from the realm of construction, lays down a clear and plain prohibition against expenditures that have not been permitted by the commission. The plaintiff is here asking that the court substitute its judgment for that of the railroad commission; he is asking this court to grant him a judgment which by virtue of both affirmative and negative provisions in the statute in question the court is without authority to grant him. *And this the plaintiff knew.* To allow the contract in question would sanction such a contract as Wilsey proposed should be made in his favor. There was utterly no difference between the two propositions in principle. It was in fact all one proposition. To hold these large expenditures are not within the statute, is to hold the statute inoperative in cases where the legislature intended it should operate.

Nor is it the slightest objection to the exercise of a state's power to prohibit corporate action, that thereby a contract with a citizen is rendered void.

> "This would make the exercise of a substantial and valuable power by a state government depend not on the actual facts of the transactions over which it lawfully seeks to extend its

control, but upon the disposition of a corporation to resort to a mere subterfuge in order to evade obligations properly imposed upon it. Public policy forbids a construction of the law which leads to such a result, unless logically unavoidable."

* * * * * * *

"One more contention remains to be noticed. It is said that the right of a citizen to contract for insurance for himself is guaranteed by the 14th Amendment, and that, therefore, he cannot be deprived by the state of the capacity to so contract through an agent. The 14th Amendment, however, does not guarantee the citizen the right to make within his state, either directly or indirectly, a contract, the making whereof is constitutionally forbidden by the state. The proposition that, because a citizen might make such a contract for himself beyond the confines of his state, therefore he might authorize an agent to violate in his behalf the laws of his state, within her own limits, involves a clear *non sequitur,* and ignores the vital distinction between acts done within and acts done beyond a state's jurisdiction."

Hooper State of California, 155 U. S. 655, 658, 659; 39 L. ed. 297.

II.

HAD PLAINTIFF NOT BEEN CREATED SUBSEQUENT TO THE ENACTMENT OF THE PUBLIC UTILITIES STATUTE, ITS REGULATIONS WOULD STILL HAVE BEEN SUSTAINABLE AS A POLICE MEASURE. IF THE SUBJECT MATTER IS ONE THAT MAY BE REGULATED, THE COURTS WILL NOT STRIKE DOWN THE LEGISLATIVE ENACTMENT. AND IT WAS PROPER FOR THE LEGISLATURE TO SAY THIS CORPORATION SHOULD NOT PAY ASTON $3500 FOR A REPORT, OR WILSEY $5000 FOR A TRIP TO EUROPE TO SELL BONDS, UNLESS THE RAILROAD COMMISSION APPROVED THE PROPOSITION.

IF A COURT CAN SEE ANY REASON WHY A POLICE REGULATION IS APPROPRIATE IN A GIVEN CASE TO WHICH IT IN TERMS APPLIES, IT CANNOT NULLIFY THE REGULATION BY HOLDING IT INAPPLICABLE.

If a part of the law under which a railroad corporation receives its franchise, prohibits that corporation and those dealing with it from making contracts which will reach its funds consisting of contributions by its stockholders, unless such contracts are authorized by a railroad commission, it is apparent that no question of unlawful legislative interference with the corporation's property can be raised. The defendant corporation was organized on May 4, 1912 (Tr. p. 15). The alleged contract was made on September 22, 1913. Doubly forcible therefore is the language of the Supreme Court hereinbefore quoted in the case of Chicago Life Ins. Co. v. Needles, 113 U. S. 574; 28 L. ed. 1087:

> "It would be extraordinary if the legislative department of a government, charged with the duty of enacting such laws as may promote the health, the morals and the prosperity of the

people, might not, when unrestrained by constitutional limitations upon its authority, provide, by reasonable regulations, against the misuse of special corporate privileges which it has granted, *and which could not, except by its sanction, express or implied, have been exercised at all.*"

Where the legislature has changed public policy, it is only in the clearest case that the new statute will be held invalid:

"This court can know nothing of public policy except from the constitution and the laws and the course of administration and decision. It has no legislative powers. It cannot amend or modify any legislative acts. It cannot examine questions as expedient or inexpedient, as politic or impolitic. Considerations of that sort must, in general, be addressed to the legislature. *Questions of policy determined there are concluded here.*"

License Tax Cases, 72 U. S. 462; 18 L. ed. 497, 500.

"This is one in the exercise of the police power, *and the means to be employed to promote the public safety are primarily in the judgment of the legislative branch of the government,* to whose authority such matters are committed, and so long as the means have a substantial relation to the purpose to be accomplished, and there is no arbitrary interference with private rights, the courts cannot interfere with the exercise of the power by enjoining regulations made in the interest of public safety which the legislature has duly enacted."

Missouri Pac. Ry. Co. v. Omaha, 235 U. S. 121; 59 L. ed. 157.

Although a regulation may be vexatious to honest dealers in a certain business yet the propriety of such regulation is for the legislature to determine and it will not be held invalid unless it appears on the face of the statute or from some fact of which the courts will take judicial notice, that it infringes some right secured by fundamental law.

> "Every possible presumption," Chief Justice Waite said, speaking for the court in the Sinking Fund cases, "is in favor of the validity of a statute, and this continues until the contrary is shown *beyond a rational doubt.* One branch of the government cannot encroach on the other without danger. The safety of our institutions depends in no small degree on a strict observance of this salutary rule."
>
> Powell v. Pennsylvania, 127 U. S. 678; 32 L. ed. 256, 257.

The Supreme Court of the United States has had frequent occasion to pass upon state statutes adopted in the exercise of police power.

> "It is undoubtedly true that it is the right of every citizen of the United States to pursue any lawful trade or business, under such restrictions as are imposed upon all persons of the same age, sex and condition. But the possession and enjoyment of all rights are subject to such reasonable conditions as may be deemed by the governing authority of the country essential to the safety, health, peace, good order and morals of the community."
>
> Field, J., in Crowley v. Christensen, 137 U. S. 86; 34 L. ed.. 623.

Referring to the fourteenth amendment, the Supreme Court, in the case next cited, said:

> "But neither the amendment, broad and comprehensive as it is, nor any other amendment was designed to interfere with the power of the state, sometimes termed its 'police power', to prescribe regulations to promote the health, peace, morals, education and good order of the people, and to legislate so as to increase the industries of the state, develop its resources and add to its wealth and prosperity."
>
> Field, J., in Barbier v. Connolly, 113 U. S. 31; 28 L. ed. 925.

In the case last mentioned, the ordinance of the City and County of San Francisco involved required the procurement of a certificate from the health officer and board of fire commissioners as a condition precedent to the doing of the business involved and the court held that this was not an improper regulation. The doing of the business, without this certificate, was made criminal.

A state may, of course, exercise police power in other instances than where the prevention of crime is intended.

> "We hold that the police power of the state embraces regulations designed to promote the public convenience or the general prosperity, as well as regulations designed to promote the public health or public morals or the public safety."
>
> Chicago, B. & Q. R. Co. v. Illinois, 200 U. S. 561, 592; 50 L. ed. 609.

> "* * * the police power is not subject to any definite limitations, but is co-extensive with

the necessities of the case and the safe-guard of the public interests''.

Canfield v. U. S., 167 U. S. 524; 42 L. ed. 262.

"*Contracts Unenforceable by Written Law.* Subject to the restrictions in the constitution, the legislature may protect public safety, health and morals. If, in the exercise of this power, the legislature prohibits certain classes of contracts or declares them void, such contracts are, of course, void and unenforceable. The intention of the legislature to withdraw the given subject matter from the scope of the contract may be expressed in different ways. The act in question may be criminal. Contracts to perform such acts will be unenforceable."

Page on Contracts, Vol. I, sec. 327.

A contract for selling tickets at less than the rate established by the interstate commerce commission is wholly illegal.

Page on Contracts, Vol. I, sec. 328.

Citing,

Raleigh etc. R. R. Co. v. Swanson, 102 Ga. 754; 28 S. E. 601.

The Supreme Court of the United States has repeatedly held that a railroad company is so public in nature that its business is subject to the regulation of a railroad commission.

"The elementary proposition that railroads, from the public nature of the business by them carried on and the interest which the public have in their operation, are subject as to their state business to *state* regulation, which may be exerted either directly by legislative authority *or by administrative bodies endowed with*

power to that end, is not and could not be successfully questioned, *in view of a long line of authorities sustaining that doctrine."*

Atlantic C. L. R. Co. v. North Carolina Corp. Com., 206 U. S. 19, 20; 51 L. ed. 942.

At an early date the Supreme Court pointed out the public nature of railways.

"Though the corporation was private, its work was public, *as much so as if it were to be constructed by the state.* Private property can be taken for a public purpose only, and not for private gain or benefit. Upon no other ground than that the purpose is public can the exercise of the power of eminent domain in behalf of such corporations be supported. This view of the subject has been taken by the Supreme Court of Michigan. Swan v. Williams, 2 Mich. 427."

Pine Grove Township v. Talcott, 86 U. S. 666; 22 L. ed. 233.

Railways are like public highways. They are the "creatures" of the law and state aid may be rendered:

"Then what is there in the Constitution of the State of Nebraska which denies this power to the Legislature? There is no direct or express prohibition. General legislative power is vested in the Legislature. None is reserved to the people of the state."

C. B. & Q. R. R. Co. v. Otoe County, 83 U. S. 667; 21 L. ed. 380.

As Mr. Justice Henshaw declared in the opinion of the Supreme Court of the State of California (166 Cal. 658), the adoption of the amendment

to section 22, article XII of the constitution, on October 10, 1911, gave the legislature power to adopt a statute, the provisions of which should not be destroyed by other provisions in the constitution.

A federal court will follow the interpretation given a statute by a state court.

Underground R. R. v. City of New York, 116 F. 959;

Chattanooga Bldg. Assn. v. Denson, 189 U. S. 408; 47 L. ed. 870.

Recent years have seen the growth of federal regulation of the interstate operations of public utilities.

The printed schedule of rates filed by a common carrier with the interstate commerce commission must contain such items as the interstate commerce commission may require and the statute fixes a penalty for failure to comply with the commission's order.

34 Stat. at L. 586;

36 Stat. at L. 548;

U. S. Compiled Statutes (Sup. 1911), p. 1201 (Act of June 18, 1910).

The commission may now establish maximum rates for interstate transportation and such rates must be adopted and followed.

(Sec. 15. Act of June 18, 1910, C. 309) 36 Stat. at L. 554;

U. S. Compiled Statutes, (Sup. 1911) p. 1297.

Congress may fix a penalty and did so for the violation of the order of the commission, the penalty being $5000 for a single offense and an addition of $5000 per day in case the offense continued. It made the penalty recoverable in a civil action. But in section 15 of the act it was also made the duty of the carrier to adopt the rate; it could be compelled to do so and thereupon the violation of the rate was a crime under additional provisions of the act.

U. S. Compiled Statutes, (Sup. 1911) p. 1302.

The federal statutes now make adequate provision for safety appliances on interstate trains. A violation of the standards fixed by the interstate commerce commission is unlawful and the violation is subjected to a penalty.

36 Stat. at L. 298. Act April 14, 1910. C. 160.
U. S. Compiled Statutes, (Sup. 1911) p. 1328.

In 1910, Congress, in amending the interstate commerce act, provided *for a commission to investigate stocks and bonds of railroad corporations.*

36 Stat. at L. 556. Act June 18, 1910, sec. 16;
U. S. Compiled Statutes, (Sup. 1911) pp. 1332, 1333.

Congress could adopt a statute of the kind here involved, even though the federal constitution is a grant of power. The act would be good as against a railway company existing under a federal charter.

Its prohibition supplementing an order of its commission would not be "special legislation", as was contended by plaintiff. The commission created could prohibit liabilities until a certain fund was raised, just as was done here.

Congress may penalize the violation of a rule established by an inspector of locomotives used in interstate commerce.

> Act of Feb. 17, 1911. C. 103, sec. 9; 36 Stat. at Large, 916;
>
> U. S. Compiled Statutes, (Sup. 1911) p. 1337.

The insurance business which is not so public as that of a public utility, yet which is public in its nature and if misconducted may greatly injure the public, is subject to regulation. The state may require certain conditions in the contract of insurance.

> Citizen's Insurance Co. v. Clay, 197 Fed. 437.

The legislature may prescribe a standard form of policy.

> In re Opinion of Justices, 97 Me. 590; 55 A. 828;
>
> Considine v. Met. Life Ins. Co., 165 Mass. 462; 43 N. E. 201.

The right to transact such business is regarded as a *franchise,* and the state may vest authority to transact such business exclusively in corporations. While at common law the right to insure was not a franchise, it is at the present time, and a company

which accepts the franchise takes it subject to the restrictions contained therein.

> John Hancock Mutual Life Ins. Co. v. Warren, 181 U. S. 73, 75.

Section 52 of the Public Utilities Act declares the right of a railroad corporation to issue stocks is a franchise. We shall hereafter show in what way the Court of Civil Appeals of Texas construed a statute similar to the act here in question.

We repeat that if a court can see any reason why a police regulation is appropriate in a given case to which it in terms applies, the court will not nullify the regulation by holding it inapplicable.

The immigration case in which the court held that the federal contract labor law did not apply to the bringing of a minister to this country to preach is familiar to this court. The court there properly held that there was no reason why the statute should apply to such a case. But we submit there was no difference between the alleged Aston contract and the attempted Wilsey contract; no difference between it and any other contract which attempted to reach what the law virtually regards as a trust fund of the stockholders. It was prohibited. *Even though it should be conceded the order in question permitted some expenditures the alleged contract was invalid; for that order specified the purposes for which expenditures could be made; it was the only order, and it declared that if the consideration of the contract exceeded $1000 the contract must be approved by the commission.*

Some courts have held that the statute prohibiting the sending of indecent matter through the mails does not include the sending of such matter by a physician, and some cases declare that in a given case the relations of the parties are to be considered, and the law given effect if they may be affected. But these are exceptional cases. In considering them the court in the case next cited, said:

> " 'In construing statutes, the well-established rule is, where the language of the statute is clear and free from ambiguity, the duty of the court is to enforce it as it is, as there is nothing to construe. Thornley v. United States, 113 U. S. 310, 5 Sup. Ct. 491, 21 L. ed. 499; Scotts v. Reid, 10 Pet. 524, 527, 9 L. ed. 519; Bate Refrigerating Co. v. Sulzberger, 157 U. S. 1, 15 Sup. Ct. 508, 39 L. ed. 601.'
>
> * * * * * *
>
> In Scotts v. Reid, the court said:
>
> 'Where the language of the act is explicit there is great danger in departing from the words used to give an effect to the law which may be supposed to have been designed by the Legislature. * * * It is not for the court to say that where the language of the statute is clear that it should be so construed as to embrace cases, because no good reason can be assigned why they are excluded from the provisions.'
>
> In United States v. Chase, supra, the court in construing this statute before it was amended by the act of September 26, 1888, said:
>
> * * * 'We recognize the value of the rule of construing statutes with reference to the evil they were designed to suppress as an important aid in ascertaining the meaning of language in them which is ambiguous and equally suscept-

ible of conflicting constructions. But this court has repeatedly held that this rule does not apply to instances which are not embraced in the language employed in the statute, or implied from a fair interpretation of its context, even though they may involve the same mischief which the statute was designed to suppress.' ''

U. S. v. Musgrave, 160 Fed. 700.

Citing the case last cited, it is said in the footnotes of the text next mentioned:

"*An exception not made by the legislature cannot be read into the statute.* Kunkalman v. Gibson, 171 Ind. 503, 84 N. E. 985; 86 N. E. 850; Siren v. State, 78 Neb. 778, 111 N. W. 798; U. S. v. Musgrave, 160 Fed. 700."

36 Cyc. 1113.

III.

THE POWER OF THE STATE EXERCISED THROUGH THE COMMISSIONS CREATED UNDER PUBLIC UTILITY STATUTES IS VALIDLY EXERCISED, AS SHOWN BY THE EARLIER CASES AND BY CASES ALREADY DECIDED UNDER THE NEW ENACTMENTS. IT IS ABSOLUTELY IMMATERIAL THAT IN A GIVEN INSTANCE THE ACT MAY HAVE BEEN VIOLATED BY PAYMENTS MADE ON CONTRACTS FULLY PERFORMED.

THERE ARE REASONS WHY A POLICE REGULATION SHOULD APPLY IN A CASE OF THIS CHARACTER, AND THE COURTS WILL NOT HOLD INAPPLICABLE A REGULATION WHICH, BY ITS TERMS, IS APPLICABLE TO THIS CASE.

Illustrations of the recognized power of the state to regulate the business of a *state* railroad corporation are shown in cases dealing with the regulation

of the service and also dealing with the regulation of the use of the funds of the corporation.

A state railway commission has power to compel physical connection between railway lines and if all the income of the company *in the state* furnishes a reasonable return, then the order is treated as valid.

> Atlantic Coast Line R. Co. v. North Carolina Corporation Commission, 206 U. S. 1; 51 L. ed. 933, 942;
>
> State of Washington ex rel. Oregon R. & Nav. Co. v. Fairchild, 224 U. S. 510; 56 L. ed. 863;
>
> Wisconsin M. & P. R. Co. v. Jacobson, 179 U. S. 287; 45 L. ed. 194.

Undoubtedly the use a railroad company makes of its funds reflects on the service it renders and, secondly, the regulation of the use of a railroad company's funds during its formative period is justifiable as a police measure extending protection to the investor.

> " * * * The commission's supervision over issues of stocks, bonds and other securities of public utilities is among the most important of its functions. It is the duty of the Commission to see to it that stocks, bonds and other securities of such utilities are issued only for the purposes authorized by law *and the proceeds thereof are applied only to the purposes* and in the amounts specified in the Commission's order" etc.
>
> In re Tidewater Southern Ry. Co. Bond Issue, Vol. 1, Opinions and Orders of Railroad Commission of California, 624, 625.

Regarding the New York statute of 1910, it was held:

> "One of the primary purposes of the general law is to prevent over capitalization and to protect the public from the floatation of securities that do not represent actual values. The mischief is just as great, whether this over capitalization arises at the initiation of the corporation or whether it is the result of a process by which property has been replaced, and the original capitalization is still carried on the books in addition to the cost of replacement. In view then of the general purposes, of the general supervision given by section 66 of the statute, and of the certificate required to be made under section 69, we are of the opinion that the statute should be so construed as to authorize a condition that those securities shall not be sold over a misleading statement in the fixed capital amount. It is true that the powers of the commission are stringently stated in the Delaware & Hudson Case, 197 N. Y. 12; 90 N. E. 60; but that statement must be read in connection with the question then before the court for decision."
>
> People v. Stevens, 143 App. Div. 789; 128 N. Y. S. 440, 444.

We take the following from a case decided by the Supreme Court of Massachusetts on January 10, 1914:

> "It is apparent from the review of statutes that the progressively developed policy of the commonwealth has been to regulate and supervise the issue of stock obligations by railroad corporations in such a way as to prevent stock watering or financial exploitation of such corporations. In earlier years statutes laid down general rules controlling the conduct of railroad corporations but leaving the execution to the

> judgment of the stockholders and officers of the corporations. Since 1894, *through the instrumentality of a public board, supervision of this corporate judgment is required, to the end that only such and so great financial obligations should be issued as would meet the reasonable necessities of the corporation.* The policy has been manifested *as to other public service corporations,* such as gas and electric light companies and street railway companies, etc. * * *
>
> The provisions of St. 1913, C. 784, secs. 15 and 16, which govern the present application must be read and interpreted *in the light of the history of the statutory development of public regulation of stock issues* of railroad corporations, etc. * * * *'Any order of the commission approving* any such issue of stocks, bonds, notes or other evidence of indebtedness may provide for the application of the proceeds thereof *to such particular uses as the commission shall by that order or by some subsequent order specify, and the corporation shall* not apply such proceeds otherwise than as specified in such order or orders' '', etc.

The court proceeded to state that the aim of the statute was that a reasonable and proper financial return for its securities should be made to the corporation and the amount so received be expended for the lawful purposes specified in the application.

> Buckley v. N. Y. N. H. & H. R. Co., 216 Mass. 432; 103 N. E. 1033.

These ventures are largely started by the public and the state has power to subject the fund contributed to protective regulation, not only in the interest of the investor but also in the interest of the public, which is to be served.

The state has the clear power to pass such laws in the interest of the general public. The power of public utilities commission to determine the purpose of and to permit a bond issue by a public utility is not to be exercised in a perfunctory way. The statute was passed to cure a well known evil.

> Interstate Tel. & Tel. Co. v. Board of Public Utilities Commissioners, 84 N. J. L. 184; 86 At. 363, 365, col. 1.

The order of a railroad commission is presumptively valid and, in the absence of proof showing clearly an abuse of power, the order will be upheld.

> State v. Louisville & N. R. Co., 62 Fla. 315; 57 So. 175.

A federal court will not hold an order of a state railroad commission is illegal unless there are very clear grounds for so doing.

> Seaboard Air Line Ry. Co. v. R. R. Commission of Georgia, 206 Fed. 181.

The Supreme Court of the United States has said that where the statute permits an appeal to the Supreme Court of the state directly from the order of the railroad commission (as here, see sec. 66 of the act), the federal courts will not, on the ground of comity, interfere until the appeal to the state Supreme Court is heard.

> Prentis v. Atlantic Coast Line Co., 211 U. S. 210; 53 L. ed. 150.

We have searched diligently to find any authority which qualifies the force of the statute of this state

creating the new railroad commission and conferring power upon it to specify the use that may be made of the proceeds of stock sales. The statute makes a use not permitted unlawful. Sound reasons for its adoption existed. Defendant is a corporation, a creature of the statute. Defendant company was created after the statute was passed. Its powers were limited by that statute. In the absence of authority against the statute, and in the face of decisions upholding its provisions, it must follow that it is a valid statute.

The agreement in a note that its repayment shall be secured by bonds secured by a first mortgage as soon as such bonds are authorized by the railroad commission cannot be enforced where the railroad has gone into bankruptcy and has not obtained an order of the railroad commission. *The court will not undertake to say that the railroad commission would have authorized the bonds.*

> Augusta Trust Co. v. Federal Trust Co., 140 Fed. 930.

In the Circuit Court of Appeals, Judge Putnam said that, if the company was yet a going concern, the court *might* entertain a bill to compel *an application* to the railroad commission.

> Augusta Trust Co. v. Federal Trust Co., 153 Fed. 157, 162.

In the case at bar the defendant earnestly and in good faith contended that it had made no contract. Its good faith in asserting its defense was never

questioned. As to whether there was a contract was a point which the trial court allowed to be thoroughly briefed. Certain it is that the court would hesitate to grant a decree in equity where the party complaining sought to evade an express order of the commission and every person connected with the company was emphatically contending that the alleged agreement had never been made, and the contract has never been carried out. The statute so clearly makes it a question in which the stockholders are concerned. The statute does not permit the court to substitute its judgment for that of the commission.

The police power of the state extends to the regulation of investment corporations and their contracts. The state may determine the form of the contract to be used by such companies. The court pointed out that freedom of contract was a qualified right, a right subject to reasonable regulations.

Standard Home Co. v. Davis, 217 F. 904, 907, 908.

Where a state statute provides that notes may be issued by a railroad corporation only upon the approval of a state railroad commission, an indorser upon a note issued without such approval is not liable. *Held also it was utterly immaterial that the defense had been waived by the company as against another holder.*

Davis v. Watertown Nat. Bank, ...Tex. Civ. App.....; 178 S. W. 593.

The Texas statute (Vernon's Sayles Civil Statutes, Art. 6717) declared:

> "Among other things, the power and authority of issuing and executing bonds or other evidences of debt, and all kinds of stocks and shares thereof and the execution of all liens and mortgages by railroad corporations in this State are special privileges, and the right of supervision, regulation, restriction and control of which has always been, is now, and shall continue to be vested in the state government to be exercised in accordance with the provisions of this and other laws."

Promissory notes executed in disregard of the foregoing statute were held invalid.

Jones v. Abernethy, ...Tex. Civ. App. .....; 174 S. W. 682.

The first Texas case declared that it was immaterial that a violation of the statute had occurred in a given case.

It is no doubt true that when an administrative department construes a statute that construction is entitled to weight. But the rule has absolutely no application where the language of a statute is not doubtful.

36 Cyc. 1142.

The federal cases referred to in the text are directly in point:

Studebaker v. Perry, 184 U. S. 258; 46 L. ed. 528;

Denning v. McClaughry, 113 F. 638; affirmed 186 U. S. 49; 46 L. ed. 1049;

U. S. v. McFarland, 28 App. Cas. 552;
Houghton v. Payne, 194 U. S. 88, 100; 48 L. ed. 891;

In the last case it is said:

> "A custom of the Department, however, long continued by successive officers, must yield to the positive language of the statute. As was said in the Graham Case (p. 221, L. ed. p. 127, Sup. Ct. Rep. p. 583), 'if there were ambiguity or doubt, then such a practice, begun so early and continued so long, would be in the highest degree persuasive, if not absolutely controlling, in its effect. But with the language clear and concise, and with its meaning evident, there is no room for construction, and consequently no need of anything to give it aid. The cases to this effect are numerous. Edwards v. Darby, 12 Wheat. 206, 6 L. ed. 603; United States v. Temple, 105 U. S. 97; 26 L. ed. 967; Swift & C. & B. Co. v. United States, 105 U. S. 691; 26 L. ed. 1108; Ruggles v. Illinois, 108 U. S. 526, 27 L. ed. 812, 2 Sup. Ct. Rep. 832."

At the outset the railroad commission was so crowded with work that it could not give prompt attention to applications or exercise the degree of supervision which was expected of it, and it would not be surprising if it allowed departures from the law in some cases, but this never was its settled practice. Obligations or shares of stock issued by railroad companies or other public utilities are issued only under the commission's order, and no member of the commission today recognizes that a public utility may use the proceeds of the sale of bonds or stocks for any purpose whatever, unless

that purpose is specified in an order of the commission.

The power here is a police power and no authority is produced to show that police power does not embrace it.

The state itself could operate its railroads. If it did so, it could subject all railroad property and contracts in relation to the same to conditions governing ordinary public contracts. *It could provide that contracts for cars, machinery and work-shops and maintenance could be made by its superintendent involving payment of amounts not exceeding $3000.00, but if the amount of the contract exceeded $3000.00, the contract must be approved by the governor. In such a case an unapproved contract in excess of $3000.00 is absolutely void and unenforceable.*

Tappan v. Western Atlantic Railroad, 62 Ga. 198.

The statute clearly applied to the contracts proposed by Aston and by Wilsey.

If a court can see any reason why a police regulation is appropriate in a given case, it can not nullify the regulation by holding it inapplicable. There are just as good grounds for holding the police regulation here in question applicable to the alleged Aston contract or to the attempted Wilsey contract, as to any other contract which it is conceivable the corporation might make. *The Massachusetts, New Jersey and Texas cases are directly in point.*

IV.

WHERE A CONTRACT IS ULTRA VIRES AND IN ADDITION VOID BECAUSE IT IS PROHIBITED, THERE IS NO CASE WHICH HOLDS THAT DAMAGES MAY BE AWARDED FOR ITS NON-FULFILLMENT. IT IS PROPERLY REPUDIATED BEFORE ITS PERFORMANCE.

And such is California law.

> "It is said, however, that when a contract which was ultra vires has been performed on one part, the other is then estopped to plead that the contract was ultra vires. Here, however, the contract was void, because against public policy. In such cases, courts will not grant relief to either party."
>
> Visalia G. and E. L. Co. v. Sims, 104 Cal. 332.

In the last mentioned case the Supreme Court of California expressly ruled that a guaranty on an *ultra vires* contract which was also illegal as being contrary to public policy, was not enforcible. The grantee of a gas franchise surrendered possession of its works and leased its rights; defendant had guaranteed certain payments by the lessee. Held, that contract was *ultra vires* and *also illegal,* that a suit was not maintainable on the executory undertaking, nor would those cases apply which allow a recovery of the value of the thing surrendered because there was no showing of benefit. The case has never been overruled or criticized in the slightest degree. It supports our contention that an illegal contract which is executory may and should be repudiated.

In the case next cited, the Supreme Court of the United States said:

> "And in regard to corporations, the rule has been well laid down by Comstock, Ch. J., in Parish v. Wheeler, 22 N. Y. 494, that the executed dealings of corporations must be allowed to stand for and against both parties when the plainest rules of good faith require it.
>
> But what is sought in the case before us is the enforcement of the unexecuted part of this agreement. So far as it has been executed, namely: the four or five years of action under it, the accounts have been adjusted, and each party has received what he was entitled to by its terms. There remains unperformed the covenant to arbitrate with regard to the value of the contract. It is the damages provided for in that clause of the contract that are sued for in this action; *damages for a material part of the contract never performed; damages for the value of a contract which was void.* It is not a case of a contract fully executed. The very nature of the suit is to recover damages for its non-performance. As to this, it is not an executed contract.
>
> Not only so, but it is a contract forbidden by public policy and beyond the power of the defendants to make. Having entered into the agreement, it was the duty of the company to rescind or abandon it at the earliest moment. This duty was independent of the clause in the contract which gave them the right to do it. Though they delayed its performance for several years, it was, nevertheless, a rightful act when it was done. Can this performance of a legal duty, a duty both to stockholders of a company and to the public, give to plaintiffs a right of action? Can they found such a right on an agreement void for want of corporate authority and forbidden by the policy of the

law? To hold that this can be done is, in our opinion, to hold that any act done under a void contract makes all its parts valid, *and that the more you do under a contract forbidden by law, the stronger the claim to its enforcement in the Courts.*"

Thomas v. West Jersey R. R. Co., 101 U. S. 71; 25 L. ed. 950, 953.

"Right to Disaffirm Ultra Vires Contracts After Part Performance. (1) In General. There are decisions which uphold the right of the corporation to disaffirm an ultra vires contract after it has been partly executed, but other courts find an estoppel in a part performance by the other party to the contract. The decisions under this head cannot be reconciled; but an examination of them will lead to the conclusion that those which support a continuing duty of rescission were cases where corporations had attempted to cast off their public duties by devolving them upon other corporations, in which case the continued execution of the agreement is regarded as a continuing violation of law carrying with it a continuing duty of rescission, which duty is not diminished by lapse of time.

(II) Contracts Abnegating Performance of Public Duties. The principle then is applicable with special force in the case of contracts whereby a corporation seeks to devolve upon another corporation, without the consent of the legislature, its public duties, in which case the courts will not allow the contract to gain strength and acquire validity by lapse of time.

(III) Contracts or Arrangements Which Are Otherwise Opposed to Public Policy. The rule applies with equal force to any contract or arrangement between corporations which are for other reasons opposed to a sound

public policy. Thus where several such corporations unite their funds and properties under an arrangement called a "trust", the object of which is to prevent competition, and to monopolize and engross an article of commerce, then the scheme is denounced by a sound public policy, and a court of justice will uphold any member of such partnership in withdrawing from it at any time.

(IV) Contracts Which Otherwise Involve Continuing Violation of Law. From these decisions we may safely collect the principle that there is always a right of rescission where a continuing performance involves a continuing violation of law. This principle has indeed been extended by some courts to cases where no question of public policy can be supposed to have been involved, but where the question was merely the right of a private corporation to withdraw, upon restoring the consideration to the other party, from a contract entered into in excess of its powers."

10 Cyc. 1153.

V.

WHILE RELIEF MAY BE GRANTED UPON AN IRREGULAR CONTRACT IN CASE THE POWER TO CONTRACT IS GENERAL AND THE MODE OF CONTRACTING IS NOT RESTRICTED BY A PROVISION ENACTED IN THE INTEREST OF PUBLIC POLICY, YET WHERE SUCH A RESTRICTION EXISTS, A CONTRACT MADE IN DISREGARD OF IT CAN GIVE RISE TO NO CAUSE OF ACTION. SUCH STATUTES PERMIT OF NO EXCEPTIONS.

It is true that where *general* power to contract for service or materials exists in a municipal corporation, it may be bound upon an implied contract

therefor resulting from its accepting and using the thing or service in question. But where the power to contract is a power to contract in a particular and restricted mode only, the statute is the measure of the power. This rule has been repeatedly laid down by the Supreme and District Courts of Appeal of California in suits against municipal corporations. And we are dealing with the contract of a quasi public corporation, at least a public utility corporation. Where the municipal corporation has general power to contract, and the statute does not indicate indispensable special requirements as to the mode, the municipal corporation may be held liable upon an implied contract for that which it had the general power to contract, but where any provision of law enacted as a matter of public policy,—such as a requirement for competitive bidding,—exists, a contract not in compliance with the statute must be treated as void, —*and this, although no* provision makes the violation of the statute a crime.

> * * * "undoubtedly a school board, like a municipal corporation, may, under some circumstances, be held liable upon an implied contract for benefits received by it, such rule of implied liability is applied only in those cases where the board or municipality is given the general power to contract with reference to a subject matter and the express contract which it has assumed to enter into in pursuance of this general power is rendered invalid for some mere irrgularity or some invalidity in the execution thereof; where, however, by statute the power of the board or municipality to make

a contract is limited to a certain prescribed method of doing so and any other method of doing it is expressly or impliedly prohibited, no implied liability can arise for benefits received under a contract made in violation of the particularly prescribed statutory mode."

* * * "where the statute prescribes the only mode by which the power to contract shall be exercised the *mode* is the *measure* of the power. A contract made otherwise than as so prescribed is not binding or obligatory as a contract *and the doctrine of implied liability has no application in such cases.*"

Reams v. Cooley, 50 Cal. Dec. 360; 152 Pac. Rep. 293, 294.

Plainly such statutes do not permit of exceptions. If they do the court could read out of the statute the legislative restriction in one case and uphold it in another. If this were true, the restriction would be utterly indefinite. The statute is too clear and plain for construction. This alleged $3500 contract fell as clearly within its terms as would have a $5000 contract with Wilsey.

VI.

GENERALLY, DAMAGES ARE NOT RECOVERABLE FOR THE BREACH OF AN ILLEGAL CONTRACT.

"A statute prohibiting the making of contracts except in a certain manner *ipso facto* makes them void, if made in any other way."

9 Cyc., 476.

"IV. Statutes Regulating Dealings in Articles of Commerce. Statutes *regulating* dealings in articles of commerce have been held

to render sales void which contravene their provisions, as for example statutes requiring weights and measures to be approved and sealed by the proper officer, or requiring goods to be *inspected,* branded, labeled, tagged, weighed, stamped, etc."

9 Cyc., 479.

Such invalidity cannot be waived.

"V. Waiver of Statutory Provisions by Agreement. A person may lawfully waive by agreement the benefit of a statutory provision. But there is an imputed exception to this general rule in case of a statutory provision whose waiver would violate public policy expressed therein, *or where rights of third parties which the statute was intended to protect are involved.*"

9 Cyc., 480.

A prohibition cannot be evaded by indirection.

"It is well settled that one cannot do by indirection that which cannot be done directly. A contract entered into in fraud or evasion of the statute is equivalent to an open violation of it."

Elliott on Contracts, Vol. II, sec. 675.

"In the light of these authorities the solution of the present question is not difficult. By the ordinance, *sale without a license* is prohibited under penalty. There is in its language *nothing which indicates* an intent to limit its scope to the exaction of a penalty, or to grant that a sale may be *lawful as between the parties, though unlawful as against its prohibitions;* nor when we consider the *subject-matter* of the legislation, is there anything to justify a *presumed intent* on the part of the lawmakers to relieve the wrongdoer from the ordinary

> consequences of a forbidden act. By common consent the liquor traffic is freighted with peril to the general welfare, and the necessity of careful regulation is universally conceded. Compliance with those regulations by all engaging in the traffic is imperative; and it cannot be presumed, in the absence of express language, that the lawmakers intended that contracts forbidden by the regulations should be as valid as though there were no such regulations, and that disobedience should be attended with no other consequence than the liability to the penalty. There is, therefore, nothing in the language of the ordinance or the subject-matter of the regulations which excepts this case from *the ordinary rule, that an act done in disobedience to the law creates no right of action which a court of justice will enforce.*"
>
> Miller v. Ammon, 145 U. S. 421; 36 L. ed. 762.

The Supreme Court, speaking of a statute of the State of Colorado prohibiting a corporation from doing business in that state until it had complied with certain conditions, said:

> "It must be conceded that if the contract on which the suit was brought was made in violation of a law of the State, it cannot be enforced in any court sitting in the State charged with the interpretation and enforcement of its laws."
>
> Cooper Mfg. Co. v. Ferguson, 113 U. S. 727, 733; 28 L. ed. 1138.

Where a statute both penalizes and prohibits and it deals with the preservation of corporate assets, a violation of it is unlawful and a contract violating it is void and no recovery can be had although con-

sideration has been parted with upon the faith of the alleged contract.

Vercoutre v. Land Co., 116 Cal. 410, 415.

"But when the restrictive policy of a law alone is in contemplation, we hold it to be a universal rule that it is unlawful to contract to do that which is unlawful to do."

The Bank of the United States v. Owens, 2 Pet. 527, 538; 7 L. ed. 508.

"There can be no civil right where there can be no legal remedy; and there can be no legal remedy for that which is itself illegal."

The Bank of the United States v. Owens, 2 Pet. 527, 539; 7 L. ed. 508.

The regulation may be of the essence of the statute:

" * * * It is quite evident that the statute was passed not only for the purpose of protecting *numerous parties who borrow money* but also the public against frauds committed on third persons, the real owners of goods, by pledging their property without their consent * * * This, therefore, being the object and intention of the Legislature, *and the requisites being such as are to be performed at the time of, and previously to,* entering into the contract, I think the contract must be held void, notwithstanding, there are specific penalties for the omission of such requisites. The late case of Cope v. Rowlands is completely in point, and reviews all the preceding cases, beginning with Bartlett v. Vinor, which alone would be sufficient to determine the present case."

Tindal, C. J., in

Ferguson v. Norman, 5 Bingham's New Cases 85; 6 Scott 794; 1 Arn. 418; 8 L. J. C. P. 3; 3 Jur. 10.

If there was doubt as to whether the state could make prohibitions and conditions operative against the management of the funds of a public service corporation after its business has been thoroughly established, there are a multitude of reasons and there is a vast amount of common experience which justify state regulation of the initial investment of the stockholders' moneys. Both the stockholder whose money is to be used and the public who are to be served are interested in at least that amount of regulation which will insure safe initial investment. There must have been some sound reason for the adoption of the act. Its provisions for protecting the funds of the company raised for construction purposes are much like those of the statutes of other states.

The scandal connected with the disbursement of a million dollars by the United Railroads, upon the Solano Irrigated Farms Company, the staying of the hand of the San Francisco, Oakland Terminal Railways, when it was entering into a power contract that meant loss to the company and its stockholders, and injury to the public;—these and a multitude of other incidents are fresh in the minds of the public as evidence that corporate management of a public utility may be mismanagement through ignorance, inexperience or dishonesty. Too many corporations have been started for the purpose of ruining stockholders, and with no regard

to the franchise exercised, and it was for the legislature to say whether some check should be imposed upon the use of the funds of stockholders of a public utility and to withdraw the power from inexperienced or experienced directors to use such funds for purposes which the railroad commission has not specified. Whatever blunders and mistakes such a commission might make at the outset, no one can question the present competency of the railroad commission of this state, or the beneficial results that have ensued even to the public utilities themselves from the exercise of its powers. The Public Utilities Act met a long felt want and it or a similar statute has found or will find its way in the statutes of every state. To apply its orders in one case and to refuse their application in another, is to destroy the effectiveness of the commission itself.

The defendant earnestly contends that it followed the only course that was proper to follow in repudiating the alleged contract; that there was no order of the railroad commission permitting the incurring of the alleged obligation; that plaintiff and his associate knew it; that it could be urged in any case that there are *some* reasons why the statute should not apply; and that if the statute could be held inapplicable to this case it could only by holding that the court may review and annul the action of the commission; that the learned trial court erred in holding that the statute and order

did not apply to this case, and that its judgment ought to be reversed.

Dated, San Francisco,
March 8, 1916.

Respectfully submitted,
A. C. Huston,
Black & Clark,
Attorneys for Plaintiff in Error.